

Crown Crafts Inc.

First Quarter Fiscal Year 2023 Conference
Call

Wednesday, August 17, 2022, 2:00 PM
Eastern

CORPORATE PARTICIPANTS

Olivia Elliott - *President, Chief Executive Officer*

Craig Demarest - *Chief Financial Officer*

PRESENTATION

Operator

Hello and good day. Welcome to the Crown Crafts Inc., First Quarter Fiscal Year 2023 Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Craig Demarest, Chief Financial Officer of Crown. Please go ahead.

Craig Demarest

Thank you, MJ. Welcome to the Crown Craft's investor conference call for the first quarter of fiscal year 2023. With me today is Olivia Elliott, the company's President and Chief Executive Officer. A telephone replay of this call will be available one hour after the end of the call through 4:00 PM Central Time on November 17. Also, a web replay of this call will be available for 90 days and can be accessed by visiting our website at www.crowncrafts.com.

Before we begin, I would like to remind listeners of the cautionary language regarding forward-looking statements contained in the press release. That same language applies to comments made in today's conference call.

I will now turn the call over to Olivia.

Olivia Elliott

Good afternoon and thank you for joining us for our first quarter fiscal year 2023 conference call. I will start off with some general comments about our ongoing strategy, our quarterly results and our current market trends. Then I will turn it over to Craig who will discuss our financial results in more detail. After that, I will have a few more comments and then we will take any questions you may have.

As I mentioned during last quarter's conference call, we are excited about our long term opportunities and we are moving forward with our strategic plan, which includes expanding in the toy category, growing our product offerings, both organically and through acquisition, increasing our direct sales to consumers, reducing operating cost and making further investments to enhance our technology and improve our organizational structure.

At the same time, we are managing our business to maximize profitability in the face of current market challenges. We are able to address these challenges from a position of strength due to our solid partnerships with retailers, our position in the marketplace and the efforts of our exceptional team.

Taking a look now at our first quarter results; first quarter net sales were \$15.7 million, down from \$18.7 million last year. A portion of the decrease in sales can be attributed to the prior year's inclusion of \$631,000 in sales associated with Carousel Designs, which ceased operations in May 2021. Multiple forces in the marketplace have contributed to the remainder of the sales decline.

However, it's important to note that we have maintained shelf space at our retailers. Our partnerships with them remain strong and we are working closely together with them to navigate the current market challenges. After spending several quarters working to build up their inventories due to supply chain constraints and high consumer demand, we are not surprised that many retailers are now in an over inventory situation and have begun to reduce their purchases.

At the same time, consumers have changed their buying behaviors due to inflation concerns. As a result, many consumers are now trading down to lower priced items, buying fewer items or foregoing some items altogether. Nevertheless, we are working with retailers to ensure that consumer demand will be satisfied at these levels.

First quarter net income was \$1.4 million or \$0.14 per diluted share compared with \$2.7 million or \$0.27 per diluted share last year. Prior year included an almost \$2 million gain of forgiveness of our Paycheck Protection Program loan. It also included an \$802,000 net loss related to Carousel Designs. Excluding the impact of the loan forgiveness and Carousel Designs, net income would have been \$1.5 million or \$0.15 per diluted share for the first quarter of last year.

For the current year, we continue to see increased costs throughout the supply chain. However, we are beginning to see those costs somewhat stabilize. We pass along these increased costs to our customers whenever we can.

We finished the quarter with \$4.1 million in cash and no borrowings on our revolving line of credit. Our inventory was \$26.4 million at the end of the quarter which is higher than usual for this time of the year due primarily to the market trends mentioned earlier. The majority of our inventory is current in-line products.

We continue to be diligent in managing inventory and we expect normal levels by the end of the third quarter. Keeping in mind that this is when we will be going into Chinese New Year, a time when we typically have higher levels of inventory compared with the rest of the year.

We also announced that our board of directors declared an \$0.08 per share cash dividend on the company's common stock that will be paid on October 7, 2022 to shareholders of record at the close of business on September 16, 2022. This represents an annualized yield of 4.8% based on yesterday's closing price. We are very pleased that our balance sheet remains strong and we can continue to reward our stockholders with an attractive dividend.

Now, I am going to turn the call over to Craig.

Craig Demarest

Thanks, Olivia. I am only going to give financial highlights. For more detailed analysis, please refer to the company's 10-Q filed with the SEC this morning. Net sales were \$15.7 million for the first quarter of fiscal '23 compared with \$18.7 million for the first quarter of the prior year, a decrease of \$3 million or 16%. Sales of bedding, blankets and accessories decreased by \$2.5 million, which include a decrease of \$631,000 due to the closure of Carousel Designs in the first quarter of last year. Sales of bibs, toys and disposable products decreased by \$543,000.

The decreases in sales are primarily due to lower replenishment orders and a major retailer. Also during the current year period, our customers began to reduce their purchases as their inventories increased, which we believe resulted from customers' excessive inventory purchases during the first quarter of calendar '22 and consumers' response to rising inflation.

Finally, in advance of the expectation that shipments to customers from our Compton warehouse would be suspended during the first days of April 2022 due to our annual inventory count, customers were encouraged to place their orders earlier than they ordinarily would have. And as a result, we estimate that approximately \$700,000 of sales were made in the fourth quarter of fiscal year '22 that would have otherwise been made in the first quarter of fiscal year '23.

Gross profit increased by \$497,000 and increased from 24.9% of net sales in the first quarter of the prior year to 32.8% of net sales for the current quarter. The increase in gross profit includes the effect of the closure of Carousel which recognized a gross loss of \$647,000 in the prior year period and included the sale of inventory below cost and the recognition of charges of \$334,000 associated with the settlement of a commitment to a supplier and \$265,000 associated with the liquidation of Carousel's remaining inventory upon the closure of the business.

Also, although the gross profit in the prior year period was impacted by increases in costs across the entire supply chain, we have realized some stabilization in input costs in the current year. Finally, we also expect to benefit in future periods from recent increases in the selling prices of our products.

Marketing and administrative expenses increased by \$47,000 and increased from 18% of net sales in the first quarter of the prior year to 21.7% of net sales for the current year quarter. The prior year quarter included \$410,000 for charges incurred by Carousel. Other items in the prior year quarter include an almost \$2 million gain recognized from the forgiveness of our PPP loan.

The provision for income taxes is based upon an annual effective tax rate on continuing operations, which was 23.5% in the current year quarter and 19.2% in the prior year. A gain on extinguishment of debt in the prior year quarter was excluded from taxable income, the effect of which lowered the effective tax rate for the prior year quarter by approximately 4 percentage points.

During both the current and prior year quarters, the company recorded discrete reserves for unrecognized tax liabilities, as well as adjustments to income tax expense associated with excess tax benefits or shortfalls arising from the vesting of non-vested stock and the exercise of stock options.

The effective tax rate from continuing operations, combined with the effect of the discrete income tax items, resulted in an overall provision for income taxes of 24.5% for the current year quarter and 18.6% for the prior year quarter.

Net income for the first quarter of fiscal '23 was \$1.4 million or \$0.14 per diluted share compared to net income of \$2.7 million or \$0.27 per diluted share for the prior year quarter. And as Olivia mentioned, the prior year quarter includes the gain from the loan forgiveness and the losses of Carousel.

And now, I'll turn the call back to Olivia.

Olivia Elliott

Thank you, Craig. While we're not satisfied with the way fiscal 2023 has started, our performance continues to reflect the strength of our partnerships, our products and our business. Our retailers continue to want to work with us and we've maintained our shelf space.

And although inflationary pressures have made consumers more price sensitive, the breadth of our portfolio ensures that we will be able to continue offering products in the price ranges that consumers are looking for. We also remain excited about our opportunities for profitable growth and we're moving forward with our strategic plan to strengthen our company's position and generate long-term value for our stockholders.

MJ, we'll now open up the line for questions.

QUESTION AND ANSWER

Operator

Thank you, Olivia. We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press "*" then "2." At this time, we will pause momentarily to assemble our roster.

Our first question today comes from Tony Chiarenza with Key Equity Investors. Please go ahead.

Tony Chiarenza

Good afternoon. Thank you for taking my questions.

Olivia Elliott

Hi Tony. How are you today?

Tony Chiarenza

I am well. How are you?

Olivia Elliott

Doing good.

Tony Chiarenza

Good. My first question is the obvious one is the inventory, you mentioned in your presentation that it's higher, obviously than it usually is this time of the year. Can you expand on that a little bit and give us a sense of how marketable it is? Is it inventory of more expensive items that are going to be more difficult to pass through the chain or what concerns do you have about it?

Olivia Elliott

I don't really have any concerns about it, it is all marketable inventory. The bigger problem is, is that most of our customers became over inventoried. And so, they are just holding back on their purchases for the time being and we should be able to ship it as soon as their inventories clear up.

Tony Chiarenza

Which should take a couple of quarters or can you actually do something in the second quarter or...?

Olivia Elliott

It depends on the SKU, some SKUs have already cleared up and we are starting to ship some and some other SKUs may be more over inventoried than others, it also depends on the retailer.

It's been very well documented in the press, with Walmart, Amazon, Target, et cetera, as to when they expect to be able to run through their inventories. So it just depends, it's all over the board.

Tony Chiarenza

Okay, but you are comfortable that it is marketable inventory, and that's not something that you're going to have to take a write-down at this point, obviously, things may change.

Olivia Elliott

Obviously, things can change. But right now, I am not worried about it. I don't like the over inventory, but I do think that we will run through it in the next few quarters.

Tony Chiarenza

Okay. Second question, how would you describe current market conditions? Are they still continued to be like they were in the first quarter or would you consider things have stabilized a bit, in terms of the customer demand?

Olivia Elliott

I think as long as the economy is where it is today that it's probably going to continue for a period of time, as far as, sell-through at the retailers. The good news is, is that infant products continue to be needed as long as people are having babies. So we may not see the same results as other people are seeing when it's completely discretionary item. If you're going to have a baby you've still got to buy the items.

Tony Chiarenza

Right, it's not an option. Finally, how would you describe your competitive position? And obviously, things have dropped, but have you maintained what you would consider your market share relative to the competitors at this point?

Olivia Elliott

We have. Our market share remains solid. Our placement at retail remains very strong. We haven't lost any shelf space and we are working with our retailers to continue to maintain that.

Tony Chiarenza

Okay. Sounds good. Now, at these sales levels, can you continue to be profitable or do you need to...obviously, this quarter, the margins were better because, obviously, of some one-time items in the last quarter. But do you expect the current gross margins to continue and be profitable, let's say, at these lower sales levels?

Olivia Elliott

I won't comment on exactly where we think gross margins will be. Yes, we can remain profitable at these sales levels, obviously, we have always watched our cost, and we will adjust cost as necessary if this continues to go on.

Tony Chiarenza

Okay, great. Thank you very much. Best of luck and thank you for addressing my questions.

Olivia Elliott

Thank you.

Operator

The next question today comes from John Deysher of Pinnacle. Please go ahead.

John Deysher

Hi good afternoon. Thanks for taking my question.

Olivia Elliott

Hi John. How are you?

John Deysher

I am good, how about yourself?

Olivia Elliott

Doing good.

John Deysher

Good. Could we talk a little bit about gross margin, it's amazing when sales dropped \$2.4 million, I am excluding Carousel and all that noise, but your gross margin only dropped \$100,000. In other words, the gross margin actually went up from 29.3% as you highlighted in the release to 33.1%. And I am just wondering, to what do you attribute that almost 400 basis point increase in gross margin? Really quite exceptional.

Olivia Elliott

We continuously watch our inputs and we adjust our cost as necessary when we see sales either dipping down or going up for that matter. So, we are pretty much known historically for always watching our cost. We also did have, as costs go up, we always pass those costs on to our retailers, but there is a delay. So, when costs started going up last year, the increase in prices started several months after that and some of it didn't even start till the fourth quarter or even the first quarter of this year. So, a little bit of it is a delay in when we get our price increases from our customers as to when we pay the cost increases to our suppliers.

John Deysher

Okay. But, so you increased prices more than your cost increased for the quarter?

Olivia Elliott

We try to maintain our profitability. So, we look at it on a percentage basis. So, if our costs go up then we are going to raise the cost to the retailer to be able to maintain our margins. It's just there is a delay in the timing.

John Deysher

You did better than maintain, you actually increased it. So, I am just trying to figure out why that is. Was there any change in business mix or anything like that?

Olivia Elliott

There is always some changes in whether it's the SKU level or the product categories, et cetera. So, there is some built-in changes there that are always ongoing that from quarter-to-quarter, we'll have some fluxes in our gross margin. So, it definitely wouldn't be the same products sold this year and last year, and there is always some kind of changes there, yes.

John Deysher

Okay. So maybe some mix and also price increases. Okay, good. Could you elaborate on your comment about expanding in the toy category? What exactly are you doing to expand the toy category?

Olivia Elliott

So, that was an acquisition we did in 2017 and it was a company that had fallen on some hard times. It used to be one of the top players in the marketplace in developmental toys. And the company that had owned them had gone through some financial difficulties. And as a result, they lost some placement, because they couldn't get inventory in. So, we have been working on that pretty steadily since we acquired them over the last five years and trying to rebuild some market share. And the growth strategy is really to go after the competitors and try to take their shelf space to build that market back up.

John Deysher

Sorry, what was the name of that company you bought in 2017?

Olivia Elliott

Sassy Baby Products.

John Deysher

Yes. Sassy, okay. And how do you go about stealing market share from competitors?

Olivia Elliott

It's all about design and creating the product that the consumer wants.

John Deysher

You don't actually segment out the toy category? It's embedded in the toys, bibs and that kind of thing.

Olivia Elliott

It's embedded with the bibs, et cetera. So, it was an acquisition, at the time our division was called Hamco. And when we acquired the toy division, we actually merged it with Hamco and changed the name of that company to Sassy.

John Deysher

Okay. Got it. And finally, also increasing direct sales to consumers, what percentage of your sales was online this quarter versus a year ago?

Olivia Elliott

Let me look that up a second. So, this year, it's pretty even, it's between 25% and 30% of our sales are internet sales. But all of those are sold. We sell those to the retailer and then they sell to the consumer. So, we are going to try to take part of those sales and go direct to the consumer.

John Deysher

Okay. So, it was about the same this quarter as it was a quarter a year ago?

Olivia Elliott

Very close.

John Deysher

25% to 30%. Okay, alright. Good. Thanks and good luck.

Olivia Elliott

Thank you very much.

Operator

Again, if you have a question please press "*" then "1".

CONCLUSION

Olivia Elliott

Okay. MJ, it looks like we don't have any more questions, so we'll just wrap it up. Thank you to everyone for your continued support and interest in our company. And a special thanks to all of our employees, suppliers and customers. We look forward to talking with you again in mid-November when we release our second quarter results. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.